

Internal Revenue Service
TEGE Appeals Programs
300 N. Los Angeles Street
Los Angeles, CA 90012

Department of the Treasury
CERTIFIED

Release Number: **201323034**
Release Date: 6/72013
Date: March 11, 2013

Taxpayer Identification Number:

Person to Contact:

Employee ID Number:

Tel:

Fax:

Refer Reply to:

In Re:

Tax Years:

UIL Index:

501.03-00

Dear :

This is a final adverse determination, effective January 1, 2007, as to your exempt status under section 501(a) as an organization described under section 501(c)(3) of the Internal Revenue Code. Our adverse determination was made for the following reason(s):

Organizations exempt from Federal income tax under section 501(c)(3) of the Internal Revenue Code are required to operate exclusively for educational, charitable or other exempt purposes. An organization is not operated for one or more exempt purposes unless it serves a public rather than a private interest. Treas. Reg. § 1.501(c)(3)-1(d)(1)(ii). During 2007 and 2008, we have determined that your organization provided immigration services for a fee in manner comparable to for-profit enterprises.

Further, an organization is not operated exclusively for one or more exempt purposes if the net earnings of the organization inure in whole or in part to the benefit of private shareholder or individuals of the organization. See Treas. Reg. § 1.501(c)(3)-1(c)(2). During 20__ and 20__, we have determined that your net earnings inured to the benefit of private individuals by regular payment of auto, mortgage and other personal expenses of officers, as well as cash withdrawals and personal checks to officers which were recorded as loans that do not appear to be bona-fide and were not contemporaneously recorded as expenditures for salary or compensation. The funds inuring to your officers were substantial in comparison to your total assets and activities and were multiple or repeated during the years. You have not implemented safeguards to prevent a recurrence of funds inuring to your founder. As such, you have not operated exclusively for exempt purposes and have operated for the benefit of private interests of individuals in contravention of the requirements of Treas. Reg. § 1.501(c)(3)-1(d)(1)(ii).

Contributions to your organization are not deductible under Code § 170. You are required to file federal Form 1120 for the year(s) shown above.

If you decide to contest this determination under the declaratory judgment provisions of Code section 7428, a petition to the United States Tax Court, the United States Court of Claims, or the district court of the United States for the District of Columbia must be filed before the 91st (ninety-first) day after the date this determination was mailed to you. Contact the clerk of the appropriate court for rules for filing petitions for declaratory judgment. To secure a petition form from the United States Tax Court, write to the United States Tax Court, 400 Second Street, N.W., Washington, D.C. 20217.

You also have the right to contact the Office of the Taxpayer Advocate. However, you should first contact the person whose name and telephone number are shown above since this person can access your tax information and can help you get answers. You can call 1-877-777-4778, and ask for Taxpayer Advocate assistance.

Taxpayer Advocate assistance cannot be used as a substitute for established IRS procedures, formal appeals procedures, etc. The Taxpayer Advocate is not able to reverse legal or technically correct tax determinations, or extend the time fixed by law that you have to file a petition in the United States Tax Court. The Taxpayer Advocate, can however, see that a tax matter, that may not have been resolved through normal channels, gets prompt and proper handling.

We will notify the appropriate State officials of this final adverse determination of your exempt status, as required by Code section 6104(c).

If you have any questions, please contact the person whose name and telephone number are shown in the heading of this letter.

Sincerely,

A handwritten signature in black ink, appearing to read "Karen A. Skinder". The signature is fluid and cursive, with the first name "Karen" being more prominent.

Karen A. Skinder
Appeals Team Manager

cc:

Internal Revenue Service
Tax Exempt and Government Entities Division
Exempt Organizations: Examinations
7850 SW 6th Court MS 7954
Plantation, FL 33324

Department of the Treasury

Date: November 22, 2011

ORG
ADDRESS

Taxpayer Identification Number:
Form:
Tax Year(s) Ended:
Person to Contact/ID Number:
Contact Numbers:
Telephone:
Fax:

Certified Mail – Return Receipt Requested

Dear :

We have enclosed a copy of our report of examination explaining why we believe revocation of your exempt status under section 501(c)(3) of the Internal Revenue Code (Code) is necessary.

If you accept our findings, take no further action. We will issue a final revocation letter.

If you do not agree with our proposed revocation, you must submit to us a written request for Appeals Office consideration within 30 days from the date of this letter to protest our decision. Your protest should include a statement of the facts, the applicable law, and arguments in support of your position.

An Appeals officer will review your case. The Appeals office is independent of the Director, EO Examinations. The Appeals Office resolves most disputes informally and promptly. The enclosed Publication 3498, *The Examination Process*, and Publication 892, *Exempt Organizations Appeal Procedures for Unagreed Issues*, explain how to appeal an Internal Revenue Service (IRS) decision. Publication 3498 also includes information on your rights as a taxpayer and the IRS collection process.

You may also request that we refer this matter for technical advice as explained in Publication 892. If we issue a determination letter to you based on technical advice, no further administrative appeal is available to you within the IRS regarding the issue that was the subject of the technical advice.

If we do not hear from you within 30 days from the date of this letter, we will process your case based on the recommendations shown in the report of examination. If you do not protest this proposed determination within 30 days from the date of this letter, the IRS will consider it to be a failure to exhaust your available administrative remedies. Section 7428(b)(2) of the Code provides, in part: "A declaratory judgment or decree under this section shall not be issued in any proceeding unless the Tax Court, the Claims Court, or the District Court of the United States for the District of Columbia determines that the organization involved has exhausted its administrative remedies within the Internal Revenue Service." We will then issue a final

revocation letter. We will also notify the appropriate state officials of the revocation in accordance with section 6104(c) of the Code.

You have the right to contact the office of the Taxpayer Advocate. Taxpayer Advocate assistance is not a substitute for established IRS procedures, such as the formal appeals process. The Taxpayer Advocate cannot reverse a legally correct tax determination, or extend the time fixed by law that you have to file a petition in a United States court. The Taxpayer Advocate can, however, see that a tax matter that may not have been resolved through normal channels gets prompt and proper handling. You may call toll-free 1-877-777-4778 and ask for Taxpayer Advocate Assistance. If you prefer, you may contact your local Taxpayer Advocate at:

If you have any questions, please call the contact person at the telephone number shown in the heading of this letter. If you write, please provide a telephone number and the most convenient time to call if we need to contact you.

Thank you for your cooperation.

Sincerely,

Nanette M. Downing
Director, EO Examinations

Enclosures:
Publication 892
Publication 3498
Report of Examination

| | | | |
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| Form 886-A (Rev. January 1994) | EXPLANATIONS OF ITEMS | | Schedule number or exhibit |
| Name of taxpayer ORG | Tax Identification Number EIN | Year/Period ended 20XX12 & 20XX12 | |

LEGEND

ORG - Organization name EIN - EIN XX - Date Address - address City -
city State - state Agent - agent President - president Vice President -
vice president POA - poa RA-1 through RA-6 - 1st through 5th RA CO-1
through CO-15 - 1st through 15th COMPANIES

Issues

Whether ORG is operated exclusively for exempt purposes described within Internal Revenue Code section 501(c)(3)?

Whether ORG is engaged primarily in activities that accomplish an exempt purpose?

Whether more than an insubstantial part of ORG' activities are in furtherance of a non-exempt purpose?

Whether ORG was operated for the purpose of serving a private benefit rather than public interests?

Whether any part of the net earnings of ORG inured to the benefit of any private shareholder or individual?

Facts

Background:

On February 27, 20XX, ORG filed original articles of incorporation with the State Secretary of State. The articles of incorporation provided that its purpose was to:

1. Provide assistance to low income families in form of housing, food, paralegal services, clothing, transportation, reading, writing, drug counseling, pastoral counseling and assisting in obtaining U.S. Citizenship for those who are from countries that are in violations of human rights.
2. Assist in the training of seeing eye dogs for those people who are blind.
3. Assist in the development of good character, morals and sportsmanship through the belief in Jesus Christ the love of Jesus Christ as our savior and teaching of the art of sailing.

On June 11, 20XX, ORG filed articles of amendment to its articles of incorporation to add Article VIII. Article VIII included additional powers, purpose, and dissolution provisions of the organization.

Form 1023 Application:

On June 14, 20XX, ORG, hereinafter, "ORG", filed a Form 1023, Application for Recognition of Exemption under Section 501(c)(3) of the Internal Revenue Code, with the Internal Revenue Service, hereinafter "IRS" or the "Service". The application represented, in part, that:

ORG's activities will entail: providing food and clothing to needy families; providing drug and family counseling to needy families; and a friend in need dog training for blind.

The organization expects to receive at least of its total support from governmental units, from contributors made directly or indirectly by the general public, or from a combination of the two.

The organization's continuous sources of financial support in order of size may be as follows:

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1. Individual donors
2. Business community
3. Governmental units
4. Other 501(c)(3) public charities

The group may also attract some income from performing exempt purpose activities which may raise money for our tax exempt purpose, cause and benefit the general public.

In response to IRS correspondence during the determination process requesting more detailed information about ORG's activities, it stated the following by letter dated November 15, 20XX:

1. We form a clothing and food drive once and sometime twice a month where we give out the item collected at CO-1 in City, State and at Address.
2. Our doors are open to anyone who need drug placement and we offer free pastoral counseling to all who come to our door
3. We stopped the dog training for the blind now we only assist in helping the blind to find a good dog to assist them
4. We have people who allow low income families to stay at their homes at no cost. We provide transportation, help in teaching them to read and write if they don't know English and we go with people to the U.S. Department of Immigration to help them fill out their forms.
5. We hold workshop or developing good character and family values and we hold sport activities.
6. We have sail boats on City State, where we teach teen ages 16 thru 22 the art of sailing.

In a letter dated January 24, 20XX, ORG was recognized by the Service as exempt from Federal income tax as an organization described in section 501(c)(3) of the Code.

Program Activities:

In a letter dated December 28, 20XX, ORG was notified that its Forms 990 for tax years ended December 31, 20XX and 20XX had been selected for examination. The initial field appointment was held on February 17, 20XX with Power of Attorneys, POA and POA, at the POA's office. During the meeting, the Power of Attorneys furnished pictures of Vice President, Vice President of ORG, working in Country. They also provided photos of Countryan natives holding signs with ORG's name in front of schools and churches. Later photos provided show the same buildings destroyed after the 20XX earthquake. The Power of Attorneys also provided a letter from RA-1 and RA-2 thanking ORG for their past assistance and requesting assistance due to tragic earthquake of January 12, 20XX.

There were several Information Document Requests issued to ORG during the course of the examination, and to date ORG has not responded completely to the document requests.

Specifically the following requested information has not been furnished:

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| IDR 01 (Exhibit #1) | <ul style="list-style-type: none"> A listing and description of the programs, events, activities conducted and services provided during the period to be examined, including relevant details, such as the date and location held, the number of participants, detail any fees charged and the purpose of the activity |
| IDR 02A (Exhibit #2) | <ul style="list-style-type: none"> All contracts and correspondence files including insurance contracts, mortgages paid by organization and contracts detailing terms of payments made by the organization |

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| | <p>to outside parties. eg: RA-3, PA who was paid large checks of \$ and \$ in 20XX.</p> <ul style="list-style-type: none"> Copies of any newsletters, publications, advertisements or pamphlets that were distributed by the organization from January 1st, 20XX to present A listing and description of the programs, events, activities conducted and services provided during the period to be examined, including relevant details, such as the date and location held, the number of participants, detail any fees charged and the purpose of the activity |
| IDR 02B (Exhibit #3) | <p>Immigration Activities:</p> <ul style="list-style-type: none"> How many clients paid fees to the organization for immigration services in 20XX? How many in 20XX? How are the organization's fees set? What is the total income and expense attributable to this activity in 20XX and in 20XX? What distinguishes the organization's immigration services from for-profit immigration services? What records are kept which document this differentiation? During the initial interview with the Power of Attorney, it was mentioned that the organization offers lifetime membership for a fee of \$ to individuals, and then provides them with immigration form filing, help securing government support for housing, education and other services. Is this correct? What records are kept to substantiate these services? Are these services available to all? On the application for exemption the organization claimed that it would assist those who are from countries in violation of human rights in obtaining U.S. Citizenship. Are all your clients seeking U.S. immigration on the basis of human rights violations? <p>Other Activities Including Yachting, Real Estate Services, Seeing Eye Dogs, Drug Counseling etc:</p> <ul style="list-style-type: none"> Please describe the types of records kept with respect to each of the services engaged and have all records available for inspection at our next appointment dated below. Who were the recipients? Who provided the services? What files are kept? What fees were paid to the organization for these services in 20XX and in 20XX? What is the total income and expense attributable to each activity in 20XX and in 20XX? What distinguishes these services from similar for-profit services? What records are kept which document this differentiation? Are these services available to all? |

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| IDR 02C (Exhibit #4) | <ul style="list-style-type: none"> • Please describe the types records kept with respect to cash withdrawals, loans, personal expenses and remuneration to officers and have all records available for inspection at our next appointment dated below. • Our initial review of the 20XX bank statements and check copies revealed numerous large checks to RA-4, Cash, counter withdrawals signed by RA-4 and several large payments for potentially personal expenses, such as Property Tax payments, Insurance, BMW car loan payments, several Mortgage payments etc. • Please furnish any documentation which explains or excludes from income these payments and provide check copies of the additional 20XX missing checks: • Check # for \$ from CO-2 acct. ##, • Check # for \$ from CO-2 acct. ##, • Check # for \$ from CO-2 acct. ##, • Check # for \$ from CO-2 acct. ##, |
| IDR 3 (Exhibit #5) | <ul style="list-style-type: none"> • Provide a detailed explanation of the programs and activities your organization conducted during the tax years ended December 31, 20XX and 20XX. • Explain, in detail, the fee structure for each of your programs for the tax years ended December 31, 20XX and 20XX. • Make client files for the tax years ended December 31, 20XX and 20XX available for inspection. • Provide all employment contracts, including any supplements and amendments, in effect during the years under examination. • Does the organization own, lease or sublease any real property? If so, is the property encumbered by debt? • Provide a list of property the organization utilizes. • Does the organization own or lease any vehicles? If yes, provide a list of all vehicles? • Who is authorized to use the organization's vehicle? |

On its Form 990 returns for the tax periods ending December 31, 20XX and 20XX, respectively, ORG has described its primary purpose and program achievements as follows:

20XX12

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| Primary Exempt Purpose: Help low income families | Program Service Expenses |
| Exempt Purpose Achievements | |
| Immigration Services | \$ |

20XX12

| | | | |
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| Organization's mission: To provide assistant to low income families in form of paralegal services, housing, food, clothing, transportation, reading, writing, drug counseling, pastoral counseling and assistant in obtaining the US citizenship for those who are from countries that are in violation of HR. | Program Service Expenses |
| Exempt Purpose Achievements | |
| Paralegal Services: Assist low income families and individuals from foreign countries who are victims of human rights violation to applied for immigration status by referring them to attorneys offices or by assisting them to fill out the appropriate paper works following the attorney's recommendations. To provide links between the community and the persons confined in correctional institutions to prepare them to reentry into society, sharing the love to God. | \$ |

Based on an interview Agent conducted with President, president of ORG on March 9, 20XX, it appears that ORG is a membership organization which currently has over 2,000 members. All of the income of ORG comes from members, Vice President, and RA-4. According to Vice President:

- The membership fee is \$ and immigration application fees are deducted from membership fees. All members are required to obtain their GED or diploma and also adopt a child in Country by providing food and other items when they come to ORG for assistance.
- The benefits provided to members of ORG include:
 - Assistance with immigration related issues
 - Marine diesel mechanics biology and boating classes taught every Sunday at CO-3
 - Boat rides
 - High school diploma/GED paid by
 - Narcotics Anonymous, Alcoholics Anonymous, and Family Counseling offered
 - Free towing services
 - fills out grants for members
- Other activities of ORG include holding religious services, providing referral services and preaching at local jails. ORG has built several schools in Country which were destroyed during the recent earthquake. ORG still donates food, DVD players, crock pots, generators, musical instruments, educational and religious materials to Country. (See Exhibit #6 for complete letter from Agent to recollecting interview.)
- ORG only has pictures and a few letters from pastors to verify charitable expenditures and activities

In a letter dated May 6, 20XX, ORG responded to the Agent's recollection of interview conducted on March 9, 20XX as described above. The letter states that ORG does ask its members for voluntary membership fee in form of a donation in order to help pay for expenses in the United States, schools in Country, homes for orphans and for whatever things members might need. The letter further states that the donation or membership fee is not mandatory and no matter what, they help members in their situation. Finally the letter states that all services are free, such as: drug counseling, family counseling, boat teaching and many more. (See Exhibit # 7 for complete response)

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Vice President conducted an interview with CO-4 reporter RA-5 on October 13, 20XX to discuss accusations that Vice President and ORG were preying on illegal aliens. In the interview Vice President stated, "We don't take advantage of anyone"; and "We put in to either re-open a case or to stop a deportation". When asked if charged money for the service, Vice President said, "No, we only help our members, to be a member of the ORG Ministry is \$. (See Exhibit # 8 for complete interview)

During the examination Agent reviewed a sample of 21 client files maintained by ORG. All of the files reviewed contained correspondence from the client to the Department of Homeland Security, U.S. Citizenship and Immigration Services. Some of the information maintained in the files included: I-765, Application of Employment Approval, I-485, Application to Register Permanent Residence; and I-589, Application for Asylum and for Withholding of Removal. The clients' current address listed on all of the applications is Address, City, State; the referenced address belongs to ORG.

During the years ended December 31, 20XX and 20XX ORG's income was generated from membership fees and contributions. As evidenced below most of ORG's revenue is generated from membership fees, which appear to primarily be charged for immigration services.

| Per 990 – December 31, 20XX | | | Per 990 – December 31, 20XX | | |
|--------------------------------|--|--|--------------------------------|--|--|
| Donor Contribution | | | Contributions | | |
| Membership Fee | | | Membership Fee | | |
| Other Donations | | | Interest | | |
| Interest | | | | | |
| COGS - Merchandise Purchase | | | | | |
| Total | | | Total | | |

Cash Withdrawals:

The bank account statements of ORG for 20XX and 20XX were reviewed and cash withdrawals were noted. The cash withdrawals were made from ORG's business checking and business money market accounts at CO-5. The majority of the withdrawals were customer withdrawals made at the bank and one ATM withdrawal was made at the CO-6. The total withdrawals made were \$ in 20XX. (See Exhibit # 9)

ORG stated that Vice President and RA-4 were lucky at the casino and would occasionally deposit their winnings into the organization's bank account and make withdrawals. ORG provided a copy of a W-2G for RA-4 which showed \$ in winnings on 10/11/20XX and a copy a their CO-2 business checking account statement for October 10, 20XX through November 8, 20XX showing a \$ deposit on 10/11/20XX as proof of deposits. (See Exhibit # 10) There was no documentation provided to show the business purpose of the cash withdrawals.

Accounts Receivable:

The general ledger was reviewed for 20XX and 20XX. Several checks and debit purchases were made to or on behalf of President and RA-4 and reported as accounts receivable. In 20XX the amounts totaled \$ for President and \$ for RA-3; and in 20XX the amounts totaled \$ for President and \$ for RA-3. (See Exhibit # 11) No documentation such as receipts was provided as to the purpose of the expenditures. There was no contemporaneous documentation of a loan, no security or repayment provisions, no interest accrued, and no repayment to ORG. The amounts were not reported as compensation to President and RA-4.

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Auto Loan Payments:

During the years under examination ORG made auto loan payments on several vehicles. ORG provided documentation which shows a check was written from their account for \$ on 6/23/20XX for a BMW Z4 Roadster for President. The documentation also showed RA-4 would be listed as the legal registered owner on the title. (See Exhibit # 12)

From reviewing the bank statements and general ledger of ORG there were several payments made to CO-7 in 20XX and 20XX. In addition, ORG made payments to CO-8 for \$ and \$. The cashier's check for \$ noted that RA-4 was the purchaser and it was purchased for RA-6. (See Exhibit # 13)

There was no documentation provided to explain of the business purpose of the vehicles. The amounts were not reported as compensation to President or RA-4.

Mortgages and Related Expenses:

The general ledger for the tax years ended December 31, 20XX and 20XX was reviewed. ORG made several mortgage and interest payments to CO-9, CO-10, CO-11, CO-12 and CO-13. There were also condo association payments made to CO-14 and CO-15. (See Exhibit #14)

The balance sheet on ORG's Forms 990 for 20XX and 20XX does not list any properties, buildings, or land as assets. No documentation was provided to show the business purpose of the mortgages and related expenses. The amounts were not reported as compensation to President or RA-4.

Law

Section 501(c)(3) of the Code exempts from federal income tax organizations organized and operated exclusively for charitable, educational, and other exempt purposes, provided that no part of the organization's net earnings inures to the benefit of any private shareholder or individual.

Section 1.501(c)(3)-1(a)(1) of the regulations provides that in order to be exempt as an organization described in section 501(c)(3) of the Code, the organization must be one that is both organized and operated exclusively for one or more of the purposes specified in that section.

Section 1.501(c)(3)-1(c)(1) of the regulations provides that an organization will not be regarded as operated exclusively for exempt purposes if more than an insubstantial part of its activities is not in furtherance of exempt purposes.

Section 1.501(c)(3)-1(d)(ii) of the regulations provides that an organization is not organized or operated exclusively for one or more exempt purposes unless it serves a public rather than a private interest. Thus, it is necessary for an organization to establish that it is not organized and operated for the benefit of private interests such as designated individuals, the creator or his family, shareholders of the organization, or persons controlled, directly or indirectly, by such private interests.

Section 1.501(c)(3)-1(d)(2) of the regulations provides that the term "charitable" is used in section 501(c)(3) of the Code in its generally accepted legal sense, and includes the relief of the poor and distressed or of the underprivileged as well as the advancement of education.

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Section 1.501(c)(3)-1(e)(1) of the regulations provides that an organization may meet the requirements of section 501(c)(3) although it operates a trade or business as a substantial part of its activities, if the operation of such trade or business is in furtherance of the organization's exempt purpose or purposes and if the organization is not organized or operated for the primary purposes of carrying on an unrelated trade or business.

In *Better Business Bureau of Washington D.C., Inc. v United States*, 326 U.S. 279 (1945), the Supreme Court held that the presence of a single non-exempt purpose, if substantial in nature, will destroy the exemption regardless of the number or importance of truly exempt purposes. The Court found that the trade association had an "underlying commercial motive" that distinguished its educational program from that carried out by a university.

In *American Institute for Economic Research v. United States*, 302 F.2d 93 (Ct. Cl. 1962), the Court considered an organization that provided analyses of securities and industries and of the economic climate in general. It sold subscriptions to various periodicals and services providing advice for purchases of individual securities. The court noted that education is a broad concept, and assumed arguendo that the organization had an educational purpose. However, the totality of the organization's activities, which included the sale of many publications as well as the sale of advice for a fee to individuals, was indicative of a business. Therefore, the court held that the organization had a significant non-exempt purpose that was not incidental to the educational purpose, and was not entitled to be regarded as exempt.

In *Easter House v U.S.*, 12 Ct. Cl. 476 (1987), *aff'd* 846 F.2d 78 (Fed Cir 1988), the court found that adoption services were the primary activity of the organization. In deciding that the organization conducted adoption services for a business purpose rather than a charitable purpose, the court considered the manner in which the organization operated. The record established a number of factors that characterize a commercial activity and which were evident in the operations of Easter House also. The court determined that the organization competed with other commercial organizations providing similar services; fees were the only source of revenue; it accumulated very substantial profits, because it set its fees in order to generate a profit; the accumulated capital was substantially greater than the amounts spent on charitable and educational activity; and the organization did not solicit and did not plan to solicit contributions. The court also found a corporate-type structure in the classes of memberships (including a single life member having inherent power that the holder could transfer like stock), and dependence on paid employees.

Revenue Ruling 76-205, 1976-1 CB 154, held that an organization formed to aid immigrants in overcoming social, cultural, and economic problems by providing personal counseling, referrals to helpful agencies, social and recreational activities, instruction in English, and distributing a newsletter containing information on attaining citizenship, securing housing, and obtaining medical care is operated exclusively for charitable and educational purposes. The organization relies upon grants and contributions from the general public and does not charge for its services.

Benefiting Private Interests

Internal Revenue Code section 501(c)(3) specifies that an exempt organization described therein is one in which "no part of the net of earnings inures to the benefit of any private shareholder or individual." The words "private shareholder or individual" in section 501 to refer to persons having a personal and private interest in the activities of the organization. Treas. Reg. § 1.501(a)-1(c). The inurement prohibition provision "is designed to prevent the siphoning of charitable receipts to insiders of the charity" United

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Cancer Council v. Commissioner, 165 F.3d 1173 (7th Cir. 1999). Reasonable compensation does not constitute inurement. Birmingham Business College v. Commissioner, 276 F.2d 476, 480 (5th Cir. 1960).

Treasury Regulation section 1.501(c)(3)-1(d)(1)(ii) provides that an organization is not organized or operated exclusively for one or more of the purposes specified in subdivision (i) of this subparagraph unless it serves a public rather than a private interest. Thus, to meet the requirement of this subdivision, it is necessary for an organization to establish that it is not organized or operated for the benefit of private interests such as designated individuals, the creator or his family, shareholders of the organization, or persons controlled, directly or indirectly, by such private interests.

Fact patterns suggesting inurement also frequently suggest excess benefit transactions between an exempt organization and a disqualified person under § 4958. The recent regulations issued under § 501(c)(3), at Treas. Reg. § 1.501(c)(3)-1(f)(ii), instruct the Service to consider a variety of factors to determine whether revocation is appropriate when section 4958 excise taxes also apply:

- (A) The size and scope of the organization's regular and ongoing activities that further exempt purposes before and after the excess benefit transaction or transactions occurred;
- (B) The size and scope of the excess benefit transaction or transactions (collectively, if more than one) in relation to the size and scope of the organization's regular and ongoing activities that further exempt purposes;
- (C) Whether the organization has been involved in multiple excess benefit transactions with one or more persons;
- (D) Whether the organization has implemented safeguards that are reasonably calculated to prevent excess benefit transactions; and
- (E) Whether the excess benefit transaction has been corrected (within the meaning of section 4958(f)(6) and § 53.4958-7), or the organization has made good faith efforts to seek correction from the disqualified person(s) who benefited from the excess benefit transaction

The Commissioner has discretion to weight the factors depending on the particular situation, but the latter two factors are weighted heavier only when the Organization has taken preemptive steps to correct the excess benefit transaction before they were brought to the Commissioner's attention. Treas. Reg. § 1.501(c)(3)-1(f)(iii).

Treas. Reg. § 1.501(c)(3)-1(f)(iv) Example 3 supposes that an organization's founder diverts significant portions of the organization's to pay personal expenses, which reduces the funds available to conduct exempt activity, over the course of multiple years. The board of trustees never authorized the organization to pay the founder's personal expenses and takes no action to seek repayment or terminate the founder's involvement with the organization. The founder claims that the payments represent loans, but no contemporaneous documentation exists and no payments of principal or interest were ever made to the organization. Based on the factors above, the regulations contemplate that not only does the diversion of funds constitute an excess benefit transaction under § 4958, but the prohibition against inurement has been violated and the organization no longer qualified as an organization described in § 501(c)(3).

Excessive compensation for services is a form of inurement. For example, in Mabee Petroleum Corp. v. U.S., 203 F. 2d 872, 875 (5th Cir. 1953), the Fifth Circuit held that the organization's payment of a full-time salary for part-time work was inurement.

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The use by insiders of the organization's property for which the organization does not receive adequate consideration is a form of inurement. See, e.g., The Founding Church of Scientology v. U.S., 412 F.2d 1197, 1201 (Ct. Cl. 1969) (holding that the insiders' use of organization-owned automobiles and housing constituted inurement); Spokane Motorcycle Club v. U.S., 222 F.Supp. 151 (E.D. Wash. 1963) (holding that the organization's provision of goods, services and refreshments to its members constituted inurement).

Loans that are financially advantageous to insiders from the organization's funds (particularly unexplained, undocumented loans) are a form of inurement. For example, in The Founding Church of Scientology, 412 F.2d at 1200-01, the Claims Court listed unexplained loans to and from insiders among the examples of inurement. In Church of Scientology v. Commissioner, 823 F.2d 1310, 1314-15, 1318 (9th Cir. 1987), the Ninth Circuit held that "debt repayments" in the form of 10 percent of the organization's income made to the organization's founder, allegedly to compensate the founder for the organization's past use of his personal income and capital, constituted inurement. In Airlie Foundation v. Commissioner, 283 F. Supp. 2d 58 (D.D.C., 20XX), the court held that forgiveness of interest was a form of inurement.

Payment to one person for services performed by another (or for services presumed to be performed, without any proof of performance) is a form of inurement. In Church of Scientology, 823 F.2d at 1314, 1317-18, the court listed royalties received by the organization's founder on the sale of publications written by others among the improper benefits received by the founder from the organization. In The Founding Church of Scientology, 412 F.2d at 1202, the court held that the payment of salary to the founder's daughter without any proof that she actually performed any services for the organization constituted inurement.

A number of courts have held that unaccounted for diversions of a charitable organization's resources by one who has complete and unfettered control can constitute inurement. Parker v. Commissioner, 365 F.2d 792, 799 (8th Cir. 1966); Kenner v. Commissioner, 318 F.2d 632 (7th Cir. 1963); Church of Scientology, 823 F.2d at 1316-17, 1319

In Greg R. Vinikoor v. Commissioner, T.C. Memo. 1998-152, the Tax Court held that whether a financial transaction constitutes a loan depends on all the facts and circumstances, including whether (1) there was a promissory note or other evidence of indebtedness; (2) interest was charged; (3) there was security or collateral; (4) there was a fixed maturity date; (5) a demand for repayment was made; (6) any actual repayment was made; (7) the transferee had the ability to repay; (8) any records maintained by the transferor and/or the transferee reflected the transaction as a loan; and (9) the manner in which the transaction was reported for Federal tax purposes.

In Rameses School of San Antonio, Texas v. Commissioner, T.C. Memo 20XX-85, the Tax Court held that a private school failed to qualify for exemption under section 501(c)(3) because it operated for the private benefit of its founder. The Tax Court stated: Factors highlighted of a prohibited relationship have included control by the founder over the entity's funds, assets, and disbursements; use of entity moneys for personal expenses; payments of salary or rent to the founder without any accompanying evidence or analysis of the reasonableness of the amounts; and purported loans to the founder showing a ready private source of credit. Nearly all of these factors are present here.

Government's Position

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Based on the examination conducted, it has been concluded that ORG does not continue to qualify for tax-exempt status as an organization described in section 501(c)(3) of the Code. ORG does not operate exclusively for section 501(c)(3) purposes, rather it has a substantial non-exempt purpose. Although it does appear that ORG conducted some charitable activities, its primary activity consists of providing immigration services for a fee and such services are in furtherance of a substantial non-exempt purpose. Our conclusion is based on the totality of factors that are noted above and discussed below.

ORG is similar to the organization is *American Institute for Economic Research* that the court concluded had a significant non-exempt commercial purpose. In that case the organization sold periodicals and provided services to individuals relating to the purchase of securities. ORG is providing services to individuals relating to immigration issues. Like the organization in *American Institute for Economic Research*, ORG is providing services to individuals for a fee. While ORG may provide some counseling services and have some charitable activities, the manner in which it operates is indicative of a business, rather than an organization described in 501(c)(3) of the Code.

In *Easter House* the court decided that the organization conducted adoption services for a business purpose rather than a charitable purpose. In reaching its decision, the court considered the manner in which the organization was operated. The following factors were established:

- The organization competed with other commercial organizations;
- Fees were the only source of revenue;
- The organization accumulated very substantial profits because of its fee structure;
- The accumulated capital was substantially greater than amounts spent on charitable and educational activity; and
- The organization did not solicit and did not plan to solicit contributions.

Several of the factors present in the *Easter House* case are also applicable to ORG. During the examination years ended December 31, 20XX and 20XX, substantially all of ORG's revenue was derived from fees. Additionally, ORG did not provide any documentation to show that they solicited or received contributions from the general public. Further, ORG appears to compete with other commercial entities; the immigration services that ORG provides are comparable to some of the services provided by similar for-profit companies.

Besides a few letters from pastors and pictures, ORG could not substantiate that they conducted any charitable activities. Client files containing applications and correspondence with the Department of Homeland Security, U.S. Citizenship and Immigration Services were the only records maintained by ORG. Several Information Document Requests were issued to identify concrete and specific exempt activities undertaken by ORG. There were five Information Document Requests either not fully or partially addressed.

While ORG may have provided some charitable activities, they are incidental when weighed against its immigration services. As provided in *Better Business Bureau of Washington D.C., Inc.* the presence of a single non-exempt purpose, if substantial in nature, will destroy the exemption regardless of the number or

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importance of truly exempt purposes. ORG immigration services are substantial and commercial in nature, and as such, the services defeat its claim to be an organization described in section 501(c)(3) of the Code.

Vice President and RA-4 are officers, directors, and "private shareholders or individuals" because they are "persons having a personal and private interest in the activities of the organization." As defined in §1.501(a)-1(c) cited above. Vice President and RA-4 are founders and vice president and president, respectively, of ORG. They have sole control over the income, disbursements and assets of ORG.

Vice President and RA-4 diverted ORG's funds for their personal benefit as illustrated by the transactions described above. They used ORG's funds to pay auto loans for personal automobiles, and there was no documentation of any business use of the vehicles. They also paid several mortgages and related expenses totaling \$ in 20XX and \$ in 20XX for personal properties.

Vice President and RA-4 used ORG's assets for their personal purposes. The hundreds of thousands of dollars recorded as accounts receivable included repeated cash withdrawals, payment of personal expenses, and checks written to and for the benefit of Vice President and RA-4.

There is no internal control to ensure that funds were used for exempt purposes. Vice President and RA-4 had free reign over the following:

- to deposit the income or not deposit the income;
- pay the note on their personal vehicles;
- use ORG's debit cards for personal expenses;
- make cash withdrawals at any time;
- write checks to themselves with no documentation required;
- and amount up receivables to ORG with no repayment made to date

There is no record that the board members questioned Vice President and RA-4's control of the funds.

Analysis under the factors laid out in Treas. Reg. § 1.501(c)(3)-1(f) supports the conclusion that revocation of ORG's exempt status is appropriate in this case. This situation is very similar to example 3 of the regulation. The funds available for ORG's activities before and after the transactions appear to have been affected. Vice President and RA-4 diverted thousands of dollars in cash withdrawals and payments of personal expenses, yet only had minimal documented charitable activities. The size and scope of the transactions are substantial in relation to ORG exempt activities. The relative size of the total accounts received owed by Vice President and RA-4 to ORG's total assets, as reported on the Organization's Forms 990, also weighs heavily against ORG's continued exempt status.

The excess benefit transactions between Vice President, RA-4 and ORG multiplied and repeated during the years at issue. No loan documentation exists, nor is Vice President or RA-4 known to have made any payments of principal or interest on the amounts recorded as accounts receivable. There were no internal controls in place, the board is non-existent, and no safeguards were put in place to prevent the occurrence of excess benefit transactions. No correction is known to have been sought by or made to the organization.

In summary Vice President and RA-4 operated ORG more like a personal business than an exempt organization. Vice President and RA-4 had control over ORG's funds, assets and disbursements; made use of the funds for personal use; and made no repayments on loans ORG made to them. Vice President

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and RA-4 essentially appear to have had access to a zero interest line of credit with no promissory notes, terms of repayment, or interest charged. The income and assets of ORG inured to the benefit of Vice President and RA-4, the vice president and president, of the organization, thus ORG was not operating exclusively for exempt purposes as required by section 501(c)(3). See Rameses School of San Antonio, Texas v. Commissioner, T.C. Memo 20XX-85.

Taxpayer's Position

The exempt organization's position has not been determined.

Conclusion

In summary, ORG is not operated exclusively for exempt purposes, because it does not engage primarily in activities that accomplish an exempt purpose. More than an insubstantial part of ORG's activities are in furtherance of non-exempt purposes that are commercial in nature. In addition, ORG a more than insubstantial portion of its operation is for the purpose of serving the private interests of its officers Vice President and RA-4.

It is recommended that ORG's tax-exempt status be revoked effective January 1, 20XX.